Legislative Proposals and Explanatory Notes Relating to Income Tax

Dividend Taxation

Published by
The Honourable James M. Flaherty, P.C., M.P.
Minister of Finance

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Canada

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Legislative Proposals

Table of Contents

1. (1) Subsection 15(1.1) of the Act is replaced by the following:

Conferring of benefit

(1.1) Notwithstanding subsection (1), where in a taxation year a corporation has paid a stock dividend to a person and it may reasonably be considered that one of the purposes of that payment was to significantly alter the value of the interest of any specified shareholder of the corporation, the fair market value of the stock dividend shall, except to the extent that it is otherwise included in computing that person's income under any of paragraphs 82(1)(*a*), (*a.1*) and (*c*) to (*e*), be included in computing the income of that person for the year.

(2) Subsection (1) applies to dividends paid after 2005.

2. (1) Subsection 82(1) of the Act is replaced by the following:

Taxable dividends received

82. (1) In computing the income of a taxpayer for a taxation year, there shall be included the total of the following amounts:

(*a*) the amount, if any, by which

(i) the total of all amounts, other than eligible dividends and amounts described in paragraph (c), (d) or (e), received by the taxpayer in the taxation year from corporations resident in Canada as, on account of, in lieu of payment of or in satisfaction of, taxable dividends,

exceeds

(ii) if the taxpayer is an individual, the total of all amounts paid by the taxpayer in the taxation year that are deemed by subsection 260(5) to have been received by another person as taxable dividends (other than eligible dividends);

(*a.1*) the amount, if any, by which

(i) the total of all amounts, other than amounts included in computing the income of the taxpayer because of paragraph (*c*), (*d*) or (*e*), received by the taxpayer in the taxation year from corporations resident in Canada as, on account of, in lieu of payment of or in satisfaction of, eligible dividends,

exceeds

(ii) if the taxpayer is an individual, the total of all amounts paid by the taxpayer in the taxation year that are deemed by subsection 260(5) to have been received by another person as eligible dividends;

(*b*) if the taxpayer is an individual, other than a trust that is a registered charity, the total of

(i) 25% of the amount determined under paragraph (*a*) in respect of the taxpayer for the taxation year, and

(ii) 45% of the amount determined under paragraph (*a.1*) in respect of the taxpayer for the taxation year;

(*c*) all taxable dividends received by the taxpayer in the taxation year, from corporations resident in Canada, under dividend rental arrangements of the taxpayer;

(*d*) all taxable dividends (other than taxable dividends described in paragraph (*c*)) received by the taxpayer in the taxation year from corporations resident in Canada that are not taxable Canadian corporations; and

(*e*) if the taxpayer is a trust, all amounts each of which is all or part of a taxable dividend (other than a taxable dividend described in paragraph (*c*) or (*d*)) that was received by the trust in the taxation year on a share of the capital stock of a taxable Canadian corporation and that can reasonably be considered to have been included in computing the income of a beneficiary under the trust who was non-resident at the end of the taxation year.

(2) Subsection (1) applies to dividends paid after 2005.

3. (1) Paragraph 87(2)(*z.2*) of the Act is replaced by the following:

Application of Parts III and III.1

(*z.2*) for the purposes of Parts III and III.1, the new corporation is deemed to be the same corporation as, and a continuation of, each predecessor corporation;

(2) Subsection 87(2) of the Act is amended by striking out the word "and" at the end of paragraph (*tt*) and by adding the following after paragraph (*uu*):

(*vv*) if the new corporation is a Canadian-controlled private corporation or a deposit insurance corporation in its first taxation year, in computing its general rate income pool at the end of that first taxation year there shall be added the total of all amounts determined under subsection 89(5) in respect of the corporation for that first taxation year; and

(*ww*) if the new corporation is neither a Canadian-controlled private corporation nor a deposit insurance corporation in its first taxation year, there shall be added in computing its low rate income pool at any time in that first taxation year the total of all amounts determined under subsection 89(9) in respect of the corporation for that first taxation year.

(3) Subsections (1) and (2) apply to amalgamations that occur, and to windings-up that begin, after 2005.

4. (1) The portion of paragraph 88(1)(*e.2*) of the Act before subparagraph (i) is replaced by the following:

(*e.2*) paragraphs 87(2)(*c*), (*d.1*), (*e.1*), (*e.3*), (*g*) to (*l*), (*l.3*) to (*u*), (*x*), (*z.1*), (*z.2*), (*aa*), (*cc*), (*ll*), (*nn*), (*pp*), (*rr*), and (*tt*) to (*ww*), subsection 87(6) and, subject to section 78, subsection 87(7) apply to the winding-up as if the references in those provisions to

(2) Paragraph 88(1)(*e.2*) of the Act is amended by adding the following after subparagraph (viii):

(ix) "subsection 89(5)" and "subsection 89(9)" were read as "subsection 89(6)" and "subsection 89(10)", respectively,

(3) Subsections (1) and (2) apply to windings-up that begin after 2005.

5. (1) Subsection 89(1) of the Act is amended by adding the following definitions in alphabetical order:

"eligible dividend" « *dividende déterminé* »

"eligible dividend" means a taxable dividend that is received by a person resident in Canada, paid after 2005 by a corporation resident in Canada and designated, as provided under subsection (14), to be an eligible dividend;

"excessive eligible dividend designation" « *désignation excessive de dividende déterminé* »

"excessive eligible dividend designation", made by a corporation in respect of an eligible dividend paid by the corporation at any time in a taxation year, means

(*a*) unless paragraph (*c*) applies to the dividend, if the corporation is in the taxation year a Canadian-controlled private corporation or a deposit insurance corporation, the amount, if any, determined by the formula

$$(A - B) \times C/A$$

where

A is the total of all amounts each of which is the amount of an eligible dividend paid by the corporation in the taxation year,

B is the corporation's general rate income pool at the end of the taxation year, and

C is the amount of the eligible dividend,

(*b*) unless paragraph (*c*) applies to the dividend, if the corporation is not a corporation described in paragraph (*a*), the amount, if any, determined by the formula

$$A \times B/C$$

where

A is the lesser of

(i) the total of all amounts each of which is an eligible dividend paid by the corporation at that time, and

(ii) the corporation's low rate income pool at that time, and

B is the amount of the eligible dividend, and

C is the amount determined under subparagraph (i) of the description of A, and

(*c*) an amount equal to the amount of the eligible dividend, if it is reasonable to consider that the eligible dividend was paid in a transaction, or as part of a series of transactions, one of the main purposes of which was to artificially maintain or increase the corporation's general rate income pool, or to artificially maintain or decrease the corporation's low rate income pool;

"general rate income pool" « *compte de revenu à taux général* »

"general rate income pool" at the end of a particular taxation year, of a taxable Canadian corporation that is a Canadian-controlled private corporation or a deposit insurance corpo-

ration in the particular taxation year, is the positive or negative amount determined by the formula

$$A - B$$

where

A is the positive or negative amount that would, but for any specified future tax consequences for the particular taxation year, be determined by the formula

$$C + 0.68(D - E - F) + G + H - I$$

where

C is the corporation's general rate income pool at the end of its preceding taxation year,

D is

(*a*) unless paragraph (*b*) applies, the corporation's taxable income for the particular taxation year, and

(*b*) if the corporation is a deposit insurance corporation in the particular taxation year, nil,

E is the amount determined by multiplying the amount, if any, deducted by the corporation under subsection 125(1) for the particular taxation year by the quotient obtained by dividing 100 by the rate of the deduction provided under that subsection for the particular taxation year,

F is

(*a*) if the corporation is a Canadian-controlled private corporation in the particular taxation year, the corporation's aggregate investment income for the particular taxation year, and

(*b*) in any other case, nil,

G is the total of all amounts each of which is

(*a*) an eligible dividend received by the corporation in the particular taxation year, or

(*b*) an amount deductible under section 113 in computing the taxable income of the corporation for the particular taxation year,

H is the total of all amounts determined under subsections (4) to (7) in respect of the corporation for the particular taxation year, and

I is

(*a*) unless paragraph (*b*) applies, the amount, if any, by which

(i) the total of all amounts each of which is the amount of an eligible dividend paid by the corporation in its preceding taxation year

exceeds

(ii) the total of all amounts each of which is an excessive eligible dividend designation made by the corporation in its preceding taxation year, or

(*b*) if subsection (4) applies to the corporation in the particular taxation year, nil, and

B is 68% of the amount, if any, by which

(*a*) the total of the corporation's full rate taxable incomes (as would be defined in the definition "full rate taxable income" in subsection 123.4(1), if that definition were read without reference to its subparagraphs (*a*)(i) to (iii)) for the corporation's preceding three taxation years, determined without reference to any specified future tax consequences, for those preceding taxation years, that arise in respect of the particular taxation year,

exceeds

(*b*) the total of the corporation's full rate taxable incomes (as would be defined in the definition "full rate taxable income" in subsection 123.4(1), if that definition were read without reference to its subparagraphs (*a*)(i) to (iii)) for those preceding taxation years.

"low rate income pool"
« compte de revenu à taux réduit »

"low rate income pool", at any particular time in a particular taxation year, of a corporation (in this definition referred to as the "non-CCPC") that is resident in Canada and is in the particular taxation year neither a Canadian-controlled private corporation nor a deposit insurance corporation, is the amount determined by the formula

$$(A + B + C + D + E + F) - (G + H)$$

where

A is the non-CCPC's low rate income pool at the end of its preceding taxation year,

B is the total of all amounts each of which is an amount deductible under section 112 in computing the non-CCPC's taxable income for the year in respect of a taxable dividend (other than an eligible dividend) that became payable, in the particular taxation year but before the particular time, to the non-CCPC by a corporation resident in Canada,

C is the total of all amounts determined under subsections (8) to (10) in respect of the non-CCPC for the particular taxation year,

D is

(*a*) if the non-CCPC would, but for paragraph (*d*) of the definition "Canadian-controlled private corporation" in subsection 125(7), be a Canadian-controlled private corporation in its preceding taxation year, 80% of its aggregate investment income for its preceding taxation year, and

(*b*) in any other case, nil,

E is

(*a*) if the non-CCPC was not a Canadian-controlled private corporation in its preceding taxation year, 80 percent of the amount determined by multiplying the amount, if any, deducted by the corporation under subsection 125(1) for that preceding taxation

year by the quotient obtained by dividing 100 by the rate of the deduction provided under that subsection for that preceding taxation year, and

(*b*) in any other case, nil,

F is

(*a*) if the non-CCPC was an investment corporation in its preceding taxation year, four times the amount, if any, deducted by it under subsection 130(1) for its preceding taxation year, and

(*b*) in any other case, nil,

G is the total of all amounts each of which is a taxable dividend (other than an eligible dividend, a capital gains dividend within the meaning assigned by subsection 130.1(4) or 131(1), or a taxable dividend deductible by the non-CCPC under subsection 130.1(1) in computing its income for the particular taxation year or for its preceding taxation year) that became payable, in the particular taxation year but before the particular time, by the non-CCPC, and

H is the total of all amounts each of which is an excessive eligible dividend designation made by the non-CCPC in the particular taxation year but before the particular time;

(2) Section 89 of the Act is amended by adding the following after subsection (3):

GRIP addition: becoming CCPC

(4) If, in a particular taxation year, a corporation is a Canadian-controlled private corporation or a deposit insurance corporation but was, in its preceding taxation year, a corporation resident in Canada other than a Canadian-controlled private corporation or a deposit insurance corporation, there may be included in computing the corporation's general rate income pool at the end of the particular taxation year, the amount determined by the formula

$$A + B + C - D - E - F - G - H$$

where

A is the total of all amounts each of which is the cost amount to the corporation of a property immediately before the end of its preceding taxation year,

B is the amount of any money of the corporation on hand immediately before the end of its preceding taxation year,

C is the amount, if any, by which

(*a*) the total of all amounts that would, if the corporation had had unlimited income for its preceding taxation year from each business carried on, and each property held, by it in that preceding taxation year, have been deductible under subsection 111(1) in computing its taxable income for that preceding taxation year

exceeds

(*b*) the total of all amounts deducted under subsection 111(1) in computing the corporation's taxable income for that preceding taxation year,

D is the total of all amounts each of which is the amount of any debt owing by the corporation, or of any other obligation of the corporation to pay any amount, that was outstanding immediately before the end of its preceding taxation year,

E is the paid up capital, immediately before the end of its preceding taxation year, of all of the issued and outstanding shares of the capital stock of the corporation,

F is the total of all amounts each of which is a reserve deducted in computing the corporation's income for its preceding taxation year,

G is the corporation's capital dividend account, if any, immediately before the end of its preceding taxation year, and

H is the corporation's low rate income pool immediately before the end of its preceding taxation year.

GRIP addition: post-amalgamation

(5) If a Canadian-controlled private corporation or a deposit insurance corporation (in this subsection referred to as the "new corporation") is formed as a result of an amalgamation (within the meaning assigned by subsection 87(1)), there shall be included in computing the new corporation's general rate income pool at the end of its first taxation year the total of all amounts each of which is

(*a*) in respect of a predecessor corporation that was, in its taxation year that ended immediately before the amalgamation (in this paragraph referred to as its "last taxation year"), a Canadian-controlled private corporation or a deposit insurance corporation, the positive or negative amount determined in respect of the predecessor corporation by the formula

$$A - B$$

where

A is the predecessor corporation's general rate income pool at the end of its last taxation year, and

B is the amount, if any, by which

(i) the total of all amounts each of which is an eligible dividend paid by the predecessor corporation in its last taxation year

exceeds

(ii) the total of all amounts each of which is an excessive eligible dividend designation made by the predecessor corporation in its last taxation year; or

(*b*) in respect of a predecessor corporation (in this paragraph referred to as the "non-CCPC predecessor") that was, in its taxation year that ended immediately before the amalgamation (in this paragraph referred to as its "last taxation year"), not a Canadian-controlled private corporation or a deposit insurance corporation, the amount determined by the formula

$$A + B + C - D - E - F - G - H$$

where

A is the total of all amounts each of which is the cost amount to the non-CCPC predecessor of a property immediately before the end of its last taxation year,

B is the amount of any money of the non-CCPC predecessor on hand immediately before the end of its last taxation year,

C is the amount, if any, by which

(i) the total of all amounts that would, if the non-CCPC predecessor had had unlimited income for its last taxation year from each business carried on, and each property held, by it in that last taxation year, have been deductible under subsection 111(1) in computing its taxable income for that last taxation year

exceeds

(ii) the total of all amounts deducted under subsection 111(1) in computing the non-CCPC predecessor's taxable income for its last taxation year,

D is the total of all amounts each of which is the amount of any debt owing by the non-CCPC predecessor, or of any other obligation of the non-CCPC predecessor to pay any amount, that was outstanding immediately before the end of its last taxation year,

E is the paid up capital, immediately before the end of its last taxation year, of all of the issued and outstanding shares of the capital stock of the non-CCPC predecessor,

F is the total of all amounts each of which is a reserve deducted in computing the non-CCPC predecessor's income for its last taxation year,

G is the non-CCPC predecessor's capital dividend account, if any, immediately before the end of its last taxation year, and

H is the non-CCPC predecessor's low rate income pool immediately before the end of its last taxation year.

GRIP addition: post-winding-up

(6) If subsection 88(1) applies to the winding-up of a subsidiary into a parent (within the meanings assigned by that subsection) that is a Canadian-controlled private corporation or a deposit insurance corporation, there shall be included in computing the parent's general rate income pool at the end of its taxation year that immediately follows the taxation year during which it receives the assets of the subsidiary on the winding-up

(*a*) if the subsidiary was, in its taxation year during which its assets were distributed to the parent on the winding-up (in this paragraph referred to as its "last taxation year"), a Canadian-controlled private corporation or a deposit insurance corporation, the positive or negative amount determined by the formula

$$A - B$$

where

A is the subsidiary's general rate income pool at the end of its last taxation year, and

B is the amount, if any, by which

(i) the total of all amounts each of which is an eligible dividend paid by the subsidiary in its last taxation year

exceeds

(ii) the total of all amounts each of which is an excessive eligible dividend designation made by the subsidiary in its last taxation year; and

(*b*) in any other case, the amount determined by the formula

$$A + B + C - D - E - F - G - H$$

where

A is the total of all amounts each of which is the cost amount to the subsidiary of a property immediately before the end of its taxation year during which its assets were distributed to the parent on the winding-up (in this paragraph referred to as its "last taxation year"),

B is the amount of any money of the subsidiary on hand immediately before the end of its last taxation year,

C is the amount, if any, by which

(i) the total of all amounts that would, if the subsidiary had had unlimited income for its last taxation year from each business carried on, and each property held, by it in that last taxation year, have been deductible under subsection 111(1) in computing its taxable income for that last taxation year

exceeds

(ii) the total of all amounts deducted under subsection 111(1) in computing the subsidiary's taxable income for its last taxation year,

D is the total of all amounts each of which is the amount of any debt owing by the subsidiary, or of any other obligation of the subsidiary to pay any amount, that was outstanding immediately before the end of its last taxation year,

E is the paid up capital, immediately before the end of its last taxation year, of all of the issued and outstanding shares of the capital stock of the subsidiary,

F is the total of all amounts each of which is a reserve deducted in computing the subsidiary's income for its last taxation year,

G is the subsidiary's capital dividend account, if any, immediately before the end of its last taxation year, and

H is the subsidiary's low rate income pool immediately before the end of its last taxation year.

GRIP addition for 2006

(7) If a corporation was (or, but for an election under subsection (11), would have been), throughout its first taxation year that includes any part of January 1, 2006, a Canadian-con-

trolled private corporation, there may be included in computing its general rate income pool at the end of its immediately preceding taxation year the amount determined by the formula

$$A - B$$

where

A is 63% of the total of all amounts each of which is the corporation's full rate taxable income (as defined in subsection 123.4(1)) for a taxation year of the corporation that ended after 2000 and before 2006, and

B is the total of all amounts each of which is a taxable dividend paid by the corporation in those taxation years.

LRIP addition: ceasing to be CCPC

(8) If, in a particular taxation year, a corporation is not a Canadian-controlled private corporation or a deposit insurance corporation but was, in its preceding taxation year, a Canadian-controlled private corporation or a deposit insurance corporation, there shall be included in computing the corporation's low rate income pool at any time in the particular taxation year the amount determined by the formula

$$A + B + C - D - E - F - G - H$$

where

A is the total of all amounts each of which is the cost amount to the corporation of a property immediately before the end of its preceding taxation year,

B is the amount of any money of the corporation on hand immediately before the end of its preceding taxation year,

C is the amount, if any, by which

(*a*) the total of all amounts that would, if the corporation had had unlimited income for its preceding taxation year from each business carried on, and each property held, by it in that preceding taxation year, have been deductible under subsection 111(1) in computing its taxable income for that preceding taxation year

exceeds

(*b*) the total of all amounts deducted under subsection 111(1) in computing the corporation's taxable income for its preceding taxation year,

D is the total of all amounts each of which is the amount of any debt owing by the corporation, or of any other obligation of the corporation to pay any amount, that was outstanding immediately before the end of its preceding taxation year,

E is the paid up capital, immediately before the end of its preceding taxation year, of all of the issued and outstanding shares of the capital stock of the corporation,

F is the total of all amounts each of which is a reserve deducted in computing the corporation's income for its preceding taxation year,

G is

(*a*) if the corporation is not a private corporation in the particular taxation year, the corporation's capital dividend account, if any, immediately before the end of its preceding taxation year, and

(*b*) in any other case, nil, and

H is the positive or negative amount determined by the formula

$$I - J$$

where

I is the corporation's general rate income pool at the end of its preceding taxation year, and

J is the amount, if any, by which

(*a*) the total of all amounts each of which is an eligible dividend paid by the corporation in its preceding taxation year

exceeds

(*b*) the total of all amounts each of which is an excessive eligible dividend designation made by the corporation in its preceding taxation year.

LRIP addition: amalgamation

(9) If a corporation that is resident in Canada and that is neither a Canadian-controlled private corporation nor a deposit insurance corporation (in this subsection referred to as the "new corporation") is formed as a result of the amalgamation or merger of two or more corporations one or more of which is a taxable Canadian corporation, there shall be included in computing the new corporation's low rate income pool at any time in its first taxation year the total of all amounts each of which is

(*a*) in respect of a predecessor corporation that was, in its taxation year that ended immediately before the amalgamation, neither a Canadian-controlled private corporation nor a deposit insurance corporation, the predecessor corporation's low rate income pool at the end of that taxation year; and

(*b*) in respect of a predecessor corporation (in this paragraph referred to as the "CCPC predecessor") that was, throughout its taxation year that ended immediately before the amalgamation (in this paragraph referred to as its "last taxation year"), a Canadian-controlled private corporation or a deposit insurance corporation, the amount determined by the formula

$$A + B + C - D - E - F - G - H$$

where

A is the total of all amounts each of which is the cost amount to the CCPC predecessor of a property immediately before the end of its last taxation year,

B is the amount of any money of the CCPC predecessor on hand immediately before the end of its last taxation year,

C is the amount, if any, by which

(i) the total of all amounts that would, if the CCPC predecessor had had unlimited income for its last taxation year from each business carried on, and each property held, by it in that last taxation year, have been deductible under subsection 111(1) in computing its taxable income for that last taxation year

exceeds

(ii) the total of all amounts deducted under subsection 111(1) in computing the CCPC predecessor's taxable income for its last taxation year,

D is the total of all amounts each of which is the amount of any debt owing by the CCPC predecessor, or of any other obligation of the CCPC predecessor to pay any amount, that was outstanding immediately before the end of its last taxation year,

E is the paid up capital, immediately before the end of its last taxation year, of all of the issued and outstanding shares of the capital stock of the CCPC predecessor,

F is the total of all amounts each of which is a reserve deducted in computing the CCPC predecessor's income for its last taxation year,

G is,

(i) if the new corporation is not a private corporation in its first taxation year, the CCPC predecessor's capital dividend account, if any, immediately before the end of its last taxation year, and

(ii) in any other case, nil, and

H is the positive or negative amount determined by the formula

$$I - J$$

where

I is the CCPC predecessor's general rate income pool at the end of its last taxation year, and

J is the amount, if any, by which

(i) the total of all amounts each of which is an eligible dividend paid by the CCPC predecessor in its last taxation year

exceeds

(ii) the total of all amounts each of which is an excessive eligible dividend designation made by the CCPC predecessor in its last taxation year.

LRIP addition: winding-up

(10) If, in a particular taxation year, a corporation (in this subsection referred to as the "parent") is neither a Canadian-controlled private corporation nor a deposit insurance corporation and in the particular taxation year all or substantially all of the assets of another corporation (in this subsection referred to as the "subsidiary") were distributed to the parent on a dissolution or winding-up of the subsidiary, there shall be included in computing the parent's low rate income pool at any time in the particular taxation year that is at or after the

end of the subsidiary's taxation year (in this subsection referred to as the subsidiary's "last taxation year") during which its assets were distributed to the parent on the winding-up,

(*a*) if the subsidiary was, in its last taxation year, neither a Canadian-controlled private corporation nor a deposit insurance corporation, the subsidiary's low rate income pool immediately before the end of that taxation year; and

(*b*) in any other case, the amount determined by the formula

$$A + B + C - D - E - F - G - H$$

where

A is the total of all amounts each of which is the cost amount to the subsidiary of a property immediately before the end of its last taxation year,

B is the amount of any money of the subsidiary on hand immediately before the end of its last taxation year,

C is the amount, if any, by which

(i) the total of all amounts that would, if the subsidiary had had unlimited income for its last taxation year from each business carried on, and each property held, by it in that last taxation year, have been deductible under subsection 111(1) in computing its taxable income for that last taxation year

exceeds

(ii) the total of all amounts deducted under subsection 111(1) in computing the subsidiary's taxable income for its last taxation year,

D is the total of all amounts each of which is the amount of any debt owing by the subsidiary, or of any other obligation of the subsidiary to pay any amount, that was outstanding immediately before the end of its last taxation year,

E is the paid up capital, immediately before the end of its last taxation year, of all of the issued and outstanding shares of the capital stock of the subsidiary,

F is the total of all amounts each of which is a reserve deducted in computing the subsidiary's income for its last taxation year,

G is,

(i) if the parent is not a private corporation in the particular taxation year, the subsidiary's capital dividend account, if any, immediately before the end of its last taxation year, and

(ii) in any other case, nil, and

H is the positive or negative amount determined by the formula

$$I - J$$

where

I is the subsidiary's general rate income pool at the end of its last taxation year, and

J is the amount, if any, by which

(i) the total of all amounts each of which is an eligible dividend paid by the subsidiary in its last taxation year

exceeds

(ii) the total of all amounts each of which is an excessive eligible dividend designation made by the subsidiary in its last taxation year.

Election: non-CCPC

(11) Subject to subsection (12), a corporation that files with the Minister on or before its filing-due date for a particular taxation year an election in prescribed form to have this subsection apply is deemed for the purposes described in paragraph (*d*) of the definition "Canadian-controlled private corporation" in subsection 125(7) not to be a Canadian-controlled private corporation at any time in or after the particular taxation year.

Revoking election

(12) If a corporation files with the Minister on or before its filing-due date for a particular taxation year a notice in prescribed form revoking, as of the end of the particular taxation year, an election described in subsection (11), the election ceases to apply to the corporation at the end of the particular taxation year.

Repeated elections: consent required

(13) If a corporation has, under subsection (12), revoked an election, any subsequent election under subsection (11) or subsequent revocation under subsection (12) is invalid unless

(*a*) the Minister consents in writing to the subsequent election or the subsequent revocation, as the case may be, and

(*b*) the corporation complies with any conditions imposed by the Minister.

Dividend designation

(14) A corporation designates a dividend it pays at any time to be an eligible dividend by notifying in writing at that time each person or partnership to whom it pays all or any part of the dividend that the dividend is an eligible dividend.

Meaning of expression "deposit insurance corporation"

(15) For the purposes of paragraphs 87(2)(*vv*) and (*ww*) (including, for greater certainty, in applying those paragraphs as provided under paragraph 88(1)(*e.2*)), the definitions "excessive eligible dividend designation", "general rate income pool", and "low rate income pool" in subsection (1), and subsections (4) to (6) and (8) to (10), a corporation is a deposit insurance corporation if it would be a deposit insurance corporation as defined in the definition "deposit insurance corporation" in subsection 137.1(5) were that definition read without reference to its paragraph (*b*) and were this Act read without reference to subsection 137.1(5.1).

(3) Subsections (1) and (2) apply to taxation years that end after 2005 except that, in respect of a dividend paid before this Act is assented to, a designation under subsection 89(14) of the Act, as enacted by subsection (2), is deemed to have been made in a timely manner if it is made on or before the day that is 90 days after the day on which this Act is assented to.

6. (1) Subsection 121 of the Act is replaced by the following:

Deduction for taxable dividends

121. There may be deducted from the tax otherwise payable under this Part by an individual for a taxation year the total of

(*a*) 2/3 of the amount, if any, that is required by subparagraph 82(1)(*b*)(i) to be included in computing the individual's income for the year; and

(*b*) 11/18 of the amount, if any, that is required by subparagraph 82(1)(b)(ii) to be included in computing the individual's income for the year.

(2) Subsection (1) applies to dividends paid after 2005.

7. (1) The definition "Canadian-controlled private corporation" in subsection 125(7) of the Act is amended by striking out the word "or" at the end of paragraph (*b*), by adding the word "or" at the end of paragraph (*c*) and by adding the following after paragraph (*c*):

(*d*) in applying subsection (1), paragraphs 87(2)(*vv*) and (*ww*) (including, for greater certainty, in applying those paragraphs as provided under paragraph 88(1)(*e.2*)), the definitions "excessive eligible dividend designation", "general rate income pool" and "low rate income pool" in subsection 89(1) and subsections 89(4) to (6), (8) to (10) and 249(4.1), a corporation that has made an election under subsection 89(11) and that has not revoked the election under subsection 89(12);

(2) Subsection (1) applies to taxation years that end after 2005.

8. (1) Paragraph 127.52(1)(*f*) of the Act is replaced by the following:

(*f*) subsection 82(1) were read without reference to paragraph 82(1)(*b*);

(2) Subsection (1) applies to dividends paid after 2005.

9. (1) The Act is amended by adding the following after section 185:

PART III.1

ADDITIONAL TAX ON EXCESSIVE ELIGIBLE DIVIDEND DESIGNATIONS

Tax on excessive eligible dividend designations

185.1 (1) A corporation that has made an excessive eligible dividend designation in respect of an eligible dividend paid by it at any time in a taxation year shall, on or before the corporation's balance-due day for the taxation year, pay a tax under this Part for the taxation year equal to the total of

(*a*) 20% of the excessive eligible dividend designation, and

(*b*) if the excessive eligible dividend designation arises because of the application of paragraph (*c*) of the definition "excessive eligible dividend designation" in subsection 89(1), 10% of the excessive eligible dividend designation.

Election to treat excessive eligible dividend designation as an ordinary dividend

(2) If, in respect of an excessive eligible dividend designation that is not described in paragraph (1)(*b*) and that is made by a corporation in respect of an eligible dividend (in this subsection and subsection (3) referred to as the "original dividend") paid by it at a particular time, the corporation would, if this Act were read without reference to this subsection, be required to pay a tax under subsection (1), and it elects in prescribed manner on or before

the day that is 90 days after the day of mailing the notice of assessment in respect of that tax that would otherwise be payable under subsection (1), the following rules apply:

(*a*) notwithstanding the definition "eligible dividend" in subsection 89(1), the amount of the original dividend paid by the corporation is deemed to be the amount, if any, by which

(i) the amount of the original dividend, determined without reference to this subsection

exceeds

(ii) the amount claimed by the corporation in the election not exceeding the excessive eligible dividend designation, determined without reference to this subsection;

(*b*) an amount equal to the amount claimed by the corporation in the election is deemed to be a separate taxable dividend (other than an eligible dividend) that was paid by the corporation immediately before the particular time; and

(*c*) each shareholder of the corporation who at the particular time held any of the issued shares of the class of shares in respect of which the original dividend was paid is deemed

(i) not to have received the original dividend, and

(ii) to have received at the particular time

(A) as an eligible dividend, the shareholder's pro-rata portion of the amount of any dividend determined under paragraph (*a*), and

(B) as a taxable dividend (other than an eligible dividend) the shareholder's pro-rata portion of the amount of any dividend determined under paragraph (*b*); and

(*d*) a shareholder's pro-rata portion of a dividend paid at any time on a class of the shares of the capital stock of a corporation is that proportion of the dividend that the number of shares of that class held by the shareholder at that time is of the number of shares of that class outstanding at that time.

Concurrence with election

(3) An election under subsection (2) in respect of an original dividend is valid only if

(*a*) it is made with the concurrence of the corporation and all its shareholders

(i) who received or were entitled to receive all or any portion of the original dividend, and

(ii) whose addresses were known to the corporation; and

(*b*) either

(i) it is made on or before the day that is 30 months after the day on which the original dividend was paid, or

(ii) each shareholder described in subparagraph (*a*)(i) concurs with the election, in which case, notwithstanding subsections 152(4) to (5), any assessment of the tax, interest and penalties payable by each of those shareholders for any taxation year shall be made that is necessary to take the corporation's election into account.

Exception for non-taxable shareholders

(4) If each shareholder who, in respect of an election made under subsection (2), is deemed by subsection (2) to have received a dividend at a particular time is also, at the particular time, a person all of whose taxable income is exempt from tax under Part I,

(*a*) subsection (3) does not apply to the election; and

(*b*) the election is valid only if it is made on or before the day that is 30 months after the day on which the original dividend was paid.

Return

185.2 (1) Every corporation resident in Canada that pays a taxable dividend (other than a capital gains dividend within the meaning assigned by subsection 130.1(4) or 131(1)) in a taxation year shall file with the Minister, not later than the corporation's filing-due date for the taxation year, a return for the year under this Part in prescribed form containing an estimate of the taxes payable by it under this Part for the taxation year.

Provisions applicable to Part

(2) Subsections 150(2) and (3), sections 151, 152, 158 and 159, subsections 161(1) and (11), sections 162 to 167 and Division J of Part I are applicable to this Part with such modifications as the circumstances require.

Joint and several liability from excessive eligible dividend designations

(3) Without limiting the liability of any person under any other provision of this Act, if a Canadian-controlled private corporation or a deposit insurance corporation pays an eligible dividend in respect of which it has made an excessive eligible dividend designation to a shareholder with whom it does not deal at arm's length, the shareholder is jointly and severally, or solidarily, liable with the corporation to pay that proportion of the corporation's tax payable under this Part because of the designation that the amount of the eligible dividend received by the shareholder is of the total of all amounts each of which is a dividend in respect of which the designation was made.

Assessment

(4) The Minister may, at any time after the last day on which a corporation may make an election under subsection 185.1(2) in respect of an excessive eligible dividend designation, assess a person in respect of any amount payable under subsection (3) in respect of the designation, and the provisions of Division I of Part I (including, for greater certainty, the provisions in respect of interest payable) apply, with any modifications that the circumstances require, to an assessment made under this subsection as though it were made under section 152.

Rules applicable

(5) Where under subsection (3) a corporation and a shareholder have become jointly and severally, or solidarily, liable to pay part or all of the corporation's tax payable under this Part in respect of an excessive eligible dividend designation described in subsection (3),

(*a*) a payment at any time by the shareholder on account of the liability shall, to the extent of the payment, discharge their liability after that time; and

(*b*) a payment at any time by the corporation on account of its liability shall discharge the shareholder's liability only to the extent of the amount determined by the formula

$$(A - B) \times C/D$$

where

A is the total of

(i) the amount of the corporation's liability, immediately before that time, under this Part in respect of the designation, and

(ii) the amount of the payment,

B is the amount of the corporation's liability, immediately before that time, under this Act,

C is the amount of the eligible dividend received by the shareholder, and

D the total of all amounts each of which is a dividend in respect of which the designation was made.

(2) Subsection (1) applies to taxation years that end after 2005 except that, in respect of a dividend paid before this Act is assented to, an election under subsection 185.1(2) of the Act, as enacted by subsection (1), is deemed to have been made in a timely manner if it is made on or before the day that is 30 months after the day on which this Act is assented to.

10. (1) Subsection 248(1) of the Act is amended by adding the following in alphabetical order:

"eligible dividend" « *dividende déterminé* »

"eligible dividend" has the meaning assigned by subsection 89(1);

"excessive eligible dividend designation" « *désignation excessive de dividende déterminé* »

"excessive eligible dividend designation" has the meaning assigned by subsection 89(1);

"general rate income pool" « *compte de revenu à taux général* »

"general rate income pool" has the meaning assigned by subsection 89(1);

"low rate income pool" « *compte de revenu à taux réduit* »

"low rate income pool" has the meaning assigned by subsection 89(1);

(2) Subsection (1) applies to taxation years that end after 2005.

11. (1) Section 249 of the Act is amended by adding the following after subsection (4):

Year end on status change

(4.1) If at any time a corporation becomes or ceases to be a Canadian-controlled private corporation, otherwise than because of an acquisition of control to which subsection (4) would, if this Act were read without reference to this subsection, apply,

(*a*) subject to paragraph (*c*), the corporation's taxation year that would, if this Act were read without reference to this subsection, include that time is deemed to end immediately before that time;

(*b*) a new taxation year of the corporation is deemed to begin at that time;

(*c*) notwithstanding subsections (1) and (3), the corporation's taxation year that would, if this Act were read without reference to this subsection, have been its last taxation year that ended before that time is deemed instead to end immediately before that time if

(i) were this Act read without reference to this paragraph, that taxation year would, otherwise than because of paragraph 128(1)(*d*), section 128.1, and paragraphs 142.6(1)(*a*) or 149(10)(*a*), have ended within the 7-day period that ended immediately before that time,

(ii) within that 7-day period no person or group of persons acquired control of the corporation, and the corporation did not become or cease to be a Canadian-controlled private corporation, and

(iii) the corporation elects, in its return of income under Part I for that taxation year to have this paragraph apply; and

(*d*) for the purpose of determining the corporation's fiscal period after that time, the corporation is deemed not to have established a fiscal period before that time.

(2) Subsection (1) applies to taxation years that end after 2005.

Explanatory Notes

Preface

These explanatory notes are provided to assist in understanding proposed amendments to the *Income Tax Act*.

The Honourable James M. Flaherty, P.C., M.P.
Minister of Finance

These notes are intended for information purposes and should not be construed as an official interpretation of the provisions they describe.

Table of Contents

General Summary: Eligible Dividends

The legislative measures described in these notes implement a new system for the taxation of "eligible dividends" paid after 2005 by corporations resident in Canada to individual shareholders resident in Canada. This new system builds upon, but does not replace, the existing "gross-up" and dividend tax credit provisions, and these notes assume that the reader is generally familiar with those provisions.

This section of the notes provides a general orientation to the new system. More detailed notes are provided in respect of each of the specific legislative measures.

From the standpoint of the individual taxpayer, an eligible dividend benefits from a 45% gross-up (as opposed to 25% for other taxable dividends from taxable Canadian corporations) and a federal tax credit equal to 11/18 of the gross-up. A dividend is an eligible dividend if the dividend-paying corporation has given the dividend recipient written notice to that effect. The recipient can rely on that notice, and need not know anything about the tax status of the corporation.

For the dividend-paying corporation too, an eligible dividend is any dividend the corporation designates to be one. However, some corporations will have a limited capacity to pay eligible dividends. If their designations exceed that capacity, they are liable to a special tax. That tax applies to the excess amount or, if the corporation can reasonably be considered to have attempted artificially to increase its capacity to pay eligible dividends, to the full amount of the eligible dividend.

Corporations' capacity to pay eligible dividends depends mostly on their status. If a corporation is a Canadian-controlled private corporation (CCPC) or a deposit insurance corporation, it can pay eligible dividends only to the extent of its "general rate income pool" (GRIP) – a balance generally reflecting taxable income that has not benefited from the section 125 small business deduction or any of certain other special tax rates.

A corporation resident in Canada that is neither a CCPC nor a deposit insurance corporation (a "non-CCPC") can pay eligible dividends in any amount, unless it has a "low rate income pool" (LRIP). The LRIP is generally made up of taxable income that benefited from the small business deduction, either in the hands of the dividend-paying non-CCPC itself (at a time when it was a CCPC) or in the hands of a CCPC that paid an ineligible dividend to the non-CCPC. Many non-CCPCs will never have an LRIP, and thus will be able to designate all of their dividends as eligible dividends. However, if it exists the LRIP balance must be reduced through the payment of ineligible dividends before a non-CCPC can pay an eligible dividend (More precisely, if a non-CCPC designates a dividend as an eligible dividend despite having an LRIP, it is liable to the special tax described above – the designated dividend remains an eligible dividend as far as the recipient of the dividend is concerned.)

A given corporation will have at most one GRIP or one LRIP at any time, and that one pool is relevant to the dividends it pays on all classes of its shares. This means that, subject to any constraints in the existing law and the need to avoid artificial manipulations of the pools, a corporation may choose which of its shareholders will receive eligible or other dividends.

Some CCPCs are, because of their size or the nature of their income, ineligible for the small business deduction. Others may be willing to forego the small business deduction in exchange for being able to pay eligible dividends subject only to the LRIP limitation. A new election allows a CCPC to do this without also giving up other benefits of CCPC status. To simplify these and other cases where an existing corporation ceases to be (or becomes) a CCPC, a taxation year-end is imposed immediately before any such change in status, whether it results from the election or otherwise.

Special rules apply to the computation of a corporation's GRIP or LRIP, as the case may be, when it becomes or ceases to be a CCPC and when it has been party to an amalgamation or a winding-up. Other rules deal with the introduction of the new system, in certain cases giving existing CCPCs a starting GRIP.

Clause 1

Consequential Amendment to Subsection 15(1.1)

ITA
15(1.1)

Subsection 15(1) of the Act includes certain shareholder benefits in income. Paragraph 15(1)(b) excludes from that general rule the payment of a stock dividend. Subsection 15(1.1) of the Act provides that this exclusion will not apply where one of the purposes of the stock dividend payment is to significantly alter the value of the interest in the corporation of any specified shareholder of the corporation, unless the amount of the dividend has been included under paragraph 82(1)(*a*) of the Act in computing the income of the person who received the stock dividend.

Consequential to the changes to subsection 82(1) (see commentary on that subsection), subsection 15(1.1) is amended to refer to new paragraphs 82(1)(*a.1*), and (*c*) to (*e*), as well as to paragraph (*a*), effective for dividends paid after 2005.

Clause 2

Taxable dividends received

ITA
82(1)

Paragraph 82(1)(*a*) of the Act provides that taxable dividends received by a Canadian-resident individual shareholder from a corporation resident in Canada are included in computing the individual's income.

Paragraph (*b*) of that subsection also generally provides a 25% "gross-up" of the amount of those dividends described in subparagraph 82(1)(*a*)(ii), which is added in computing the income of an individual. Section 121 of the Act provides a dividend tax credit equal to 2/3 of the gross-up. Subsection 82(1) is amended to introduce a new gross-up of 45% in respect of eligible dividends received by a taxpayer.

Subsection 82(1) is also amended by moving the substance of existing subparagraph 82(1)(*a*)(i) into new paragraphs 82(1)(*c*) and (*d*), and the substance of subparagraph (*a*)(i.1) into new paragraph 82(1)(*e*).

Amended paragraph 82(1)(*a*) includes in income taxable dividends received by a taxpayer other than eligible dividends and amounts described in new paragraph (*c*), (*d*) or (*e*), and new paragraph (*a.1*) includes in income eligible dividends received by a taxpayer other than amounts described in new paragraph (*c*), (*d*) or (*e*). Subparagraph (i) in amended paragraph 82(1)(*b*) contains the existing gross-up of 25% applicable in respect of taxable dividends included in income under amended paragraph 82(1)(a). Subparagraph (ii) in amended paragraph 82(1)(*b*) provides for the new gross-up of 45% applicable in respect of eligible dividends included in income under new paragraph 82(1)(*a.1*).

These changes to subsection 82(1) apply to dividends paid after 2005.

Clause 3

Consequential Amendments to Subsection 87(2)

ITA
87(2)

Subsection 87(2) of the Act contains rules that apply where two or more taxable Canadian corporations amalgamate to form a new corporation.

ITA
87(2)(*z.2*)

Paragraph 87(2)(*z.2*) of the Act is one of a number of rules in subsection 87(2) of the Act that apply where two or more taxable Canadian corporations amalgamate to form a new corporation. This paragraph ensures that the new corporation is treated as the same corporation as, and a continuation of, each predecessor for the purpose of the additional tax on excessive elections set out in Part III of the Act.

Paragraph 87(2)(*z.2*) is amended to apply also for the purposes of new Part III.1, which introduces an additional tax on excessive eligible dividend designations (see commentary on new Part III.1).

Amended paragraph 87(2)(*z.2*) applies to amalgamations that occur, and (via amended paragraph 88(1)(*e.2*) of the Act) to windings-up that begin, after 2005.

ITA
87(2)(*vv*) and (*ww*)

Where the new corporation is a Canadian-controlled private corporation or a deposit insurance corporation in its first taxation year, new paragraph 87(2)(*vv*) applies to ensure that the total of all the amounts determined in respect of the new corporation under new subsection 89(5) of the Act for its first taxation year (see commentary on that subsection) is added in computing the new corporation's general rate income pool at the end of that taxation year (see commentary for the new definition "general rate income pool" in subsection 89(1)).

Where the new corporation is neither a Canadian-controlled private corporation nor a deposit insurance corporation in its first taxation year, new paragraph 87(2)(*ww*) applies to ensure that the total of all the amounts determined in respect of the new corporation under new subsection 89(9) of the Act for its first taxation year (see commentary on that subsection) is added in computing the new corporation's low rate income pool at any time in that taxation year (see commentary for the new definition "low rate income pool" in subsection 89(1)).

New paragraphs 87(2)(*vv*) and (*ww*) apply to amalgamations that occur, and (via amended paragraph 88(1)(*e.2*) of the Act) to windings-up that begin, after 2005.

Clause 4

Consequential Amendment to Paragraph 88(1)(*e.2*)

ITA
88(1)(*e.2*)

Subsection 88(1) of the Act provides rules that apply where a subsidiary has been wound up into its parent corporation, if both corporations are taxable Canadian corporations and the parent owns at least 90% of the issued shares of each class of the subsidiary's capital stock.

Paragraph 88(1)(*e.2*) of the Act provides that a number of the rules that apply to amalgamations under subsection 87(2) of the Act also apply, with certain modifications, to windings-up under subsection 88(1). Consequential to the additions of new paragraphs 87(2)(*vv*) and (*ww*) (see commentary to subsection 87(2)), paragraph (*e.2*) is amended to ensure that the rules contained in those paragraphs apply to windings-up to which subsection 88(1) applies as if the references in those paragraphs to "subsection 89(5)" and "subsection 89(9)" were read as references to "subsection 89(6)" and "subsection 89(10)", respectively.

Amended paragraph 88(1)(*e.2*) applies to windings-up that begin after 2005.

Clause 5

Definitions

ITA
89(1)

Subsection 89(1) of the Act, which defines certain terms that apply to corporations and their shareholders, is amended by adding a number of new definitions.

"eligible dividend"

The new "eligible dividend" definition is most notably relevant for the purposes of the 45% "gross-up" in amended subsection 82(1) and the corresponding dividend tax credit of 11/18 in new paragraph 121(*b*) of the Act (see commentaries on subsection 82(1) and section 121).

An "eligible dividend" is a taxable dividend that is received by a person resident in Canada, paid after 2005 by a corporation resident in Canada and designated in the manner set out under new subsection 89(14) (see commentary on that subsection) to be an eligible dividend. Setting aside any election that may be made under new Part III.1 (see commentary on Part III.1, particularly with respect to new subsection 185.1(2)), this means that a taxable dividend that satisfies these requirements is an eligible dividend notwithstanding that the corporation in paying the dividend may have made an excessive eligible dividend designation (see commentary on the definition "excessive eligible dividend designation" in subsection 89(1)). That is, the designation by itself makes a taxable dividend an eligible dividend, but by the same token a taxable dividend is only an eligible dividend if is designated as such.

It is worth noting that because an eligible dividend must be a taxable dividend received by a person resident in Canada, capital dividends and capital gains dividends will in no case be eligible dividends: the definition "taxable dividend" in subsection 89(1) is defined to exclude capital dividends; and capital gains dividends are deemed by paragraph 130.1(4)(*b*) and 131(*b*), as the case may be, not to be amounts received as dividends. However, deemed dividends, such as those that are described under section 84 of the Act, can, if they otherwise satisfy the requirements set in the definition eligible definition and are designated by the corporation that is treated as having paid them, be eligible dividends.

The new definition "eligible dividend" in subsection 89(1) applies in respect of taxation years that end after 2005.

"excessive eligible dividend designation"

The new definition "excessive eligible dividend designation" is principally relevant for the purposes of the additional tax on excessive eligible dividend designations in new Part III.1 of the Act (see commentary on that new part).

Whether a corporation has made an excessive eligible dividend designation in respect of an eligible dividend paid by it at any time in a taxation year will depend partly on whether the corporation is a Canadian-controlled private corporation (CCPC) (within the meaning assigned by subsection 125(7); see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7) and new subsection 249(4.1)) or a deposit insurance corporation (DIC) (within the meaning assigned by new subsection 89(15); see commentary on that subsection) and to what extent the corporation has a balance in its general rate income pool (GRIP) or low rate income pool (LRIP), as the case may be (see commentaries on the new definitions "general rate income pool" and "low rate income pool" in subsection 89(1)).

Unless paragraph (*c*) applies, paragraph (*a*) of the definition applies in respect of eligible dividends paid by CCPCs and DICs. The amount, if any, of an excessive eligible dividend designation made by a CCPC or DIC is determined by way of a formula, which can be described as having two parts: the first part, (A – B), identifies the amount, if any, by which the aggregate of all eligible dividends paid by the corporation in the taxation exceeds the corporation's GRIP at the end of the year; and the second part, C/A, prorates the amount of any excess on an eligible dividend by eligible dividend basis.

As a result, the ability of CCPCs and DICs to pay eligible dividends in any given taxation year without making an excessive eligible dividend designation is limited under these rules to the extent that they have a GRIP at the end of the taxation year (and to the extent that paragraph (*c*) does not apply in respect of the eligible dividend). However, this also means that a CCPC or DIC can pay an eligible dividend at any particular time in a taxation year even if it has no balance in its GRIP at that time, provided the CCPC or DIC has a sufficient GRIP at the end of the year.

Examples

Situation: *A CCPC pays in the particular taxation year a $10,000 eligible dividend to each of its 20 Class A shareholders, for an aggregate amount of $200,000. At the end of the particular taxation year, the CCPC has a GRIP of $100,000.*

Result: *Setting aside any election that may be made under Part III.1, the CCPC paid $100,000 more in eligible dividends than it had in its GRIP at the end of the particular taxation year. As a result, the CCPC made an excessive eligible dividend designation of $5,000 in respect of each eligible dividend it paid in the particular taxation year.*

Situation: *On January 15, 2007, a CCPC pays a $5,000 eligible dividend to each of its four Class C shareholders, for an aggregate amount of $20,000. The CCPC had a GRIP of nil at the end of its 2006 taxation year, and all of its business income for its 2007 taxation year was eligible for the small business deduction in subsection 125(1) of the Act. The CCPC did however receive, immediately prior to its December 31st, 2007 taxation year end, a $20,000 eligible dividend from a public corporation for which it claimed a deduction from income in computing its taxable income. At the end of its 2007 taxation year, the CCPC therefore had a $20,000 GRIP.*

Result: *The CCPC – even though it paid the eligible dividend of $20,000 at a time in its 2007 taxation year when it had no amounts to include in its GRIP – made no excessive eligible dividend designation in respect of the $20,000 eligible dividend it paid, because it had a GRIP balance of $20,000 at the end of that taxation year.*

Unless paragraph (*c*) applies, paragraph (*b*) of the definition applies in respect of eligible dividends paid by corporations other than corporations described in paragraph (*a*). Paragraph (*b*) thus applies to public corporations, among others. Although the amount of an excessive eligible dividend designation is determined under this paragraph in a manner similar to paragraph (*a*) – by way of a formula that may be described as having two parts comparable to those described in respect of paragraph (*a*), two distinctions bear noting to illustrate the intended operation of paragraph (*b*): first, a corporation's LRIP is calculated at any time in a corporation's taxation year whereas a corporation's GRIP is calculated at the end of the taxation year (see commentaries to the new definitions "low rate income pool" and "general rate income pool" in subsection 89(1)); and the formula in paragraph (*b*), unlike paragraph (*a*), effectively introduces an ordering rule by requiring corporations, in order to avoid the additional tax on excessive eligible dividend designations (see commentary on new Part III.1), to first pay taxable dividends other than eligible dividends to the extent of its LRIP at the time it pays the dividends.

This also means, however, that – subject to the application of paragraph (*c*) of the definition – corporations described in paragraph (*b*) that at any particular time have no LRIP may pay eligible dividends without restriction.

Examples

Situation: *A public corporation pays, on December 15, 2006, a $5 eligible dividend to each of its 100,000 Class C shareholders, for an aggregate amount of $500,000. At the time the eligible dividends were paid, the public corporation had a LRIP of nil.*

Result: *The public corporation made no excessive eligible dividend designation in respect of the eligible dividends it paid on March 15, 2007, since the lesser of the aggregate of all eligible dividends paid at that time, $500,000, and the public corporation's LRIP at that time, nil – A in the formula in paragraph (b) of the definition, is nil.*

Situation: *A non-CCPC private corporation pays, on March 15, 2007, a $20,000 eligible dividend to each of its two Class A shareholders, for an aggregate amount of $40,000. At the time the eligible dividends were paid, the non-CCPC private corporation had a LRIP of $18,000.*

Result: *The non-CCPC private corporation made an excessive eligible dividend designation in respect of the eligible dividends it paid on December 15, 2006, since the lesser of the aggregate of all eligible dividends paid at that time, $40,000, and the non-CCPC private corporation's LRIP at that time, $18,000 is $18,000. In respect of each eligible dividend paid, the non-CCPC private corporation made an excessive eligible dividend designation of $9,000 – that proportion of $18,000 that the amount of the eligible dividend paid, $20,000, is of the total of all amounts each of which was an eligible dividend paid by the non-CCPC private corporation at that time, $40,000.*

Paragraph (*c*) of the definition is an anti-avoidance provision. It applies in respect of an eligible dividend paid by a corporation – regardless of whether paragraph (*a*) or (*b*) would otherwise apply – if it is reasonable to consider that the eligible dividend was paid in a transaction, or as part of a series of transactions, one of the main purposes of which was to artificially manipulate the corporation's GRIP or LRIP, as the case may be.

In general terms, it is intended that a corporation be considered to have artificially maintained or increased its GRIP if the transaction or series of transactions produces a GRIP that is unreflective of income retained by it after payment of tax under Part I (whether the tax is paid by the corporation or another corporation) at a rate not less than that which applies to full rate taxable income (as defined in subsection 123.4(1) of the Act). Likewise, it is intended that a corporation generally be considered to have artificially maintained or decreased its LRIP if the transaction or series of transactions produces a LRIP that is unreflective of income retained by it after payment of tax under Part I (whether the tax is paid by the corporation or another corporation) at a rate less than that which applies to full rate taxable income.

If this paragraph applies, the amount of the excessive eligible dividend made by the corporation is equal to the amount of the eligible dividend.

The new definition "excessive eligible dividend designation" in subsection 89(1) applies in respect of taxation years that end after 2005.

"general rate income pool"

The new definition "general rate income pool" (GRIP) in subsection 89(1) of the Act applies in respect of taxable Canadian corporations that are Canadian-controlled private corporations (CCPCs) (within the meaning assigned by subsection 125(7); see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7) and new subsection 249(4.1)) or deposit insurance corporations (DICs) (within the meaning assigned by new subsection 89(15); see commentary on that subsection), and is generally relevant for determining the extent to which such corporations can pay eligible dividends in any given taxation year without making an excessive eligible dividend designation .

The general rate income pool (GRIP) of a corporation at the end of a particular taxation year is the positive or negative amount calculated by reference to a formula:

$$A - B$$

In broad terms, A is the corporation's GRIP at the end of the taxation year determined without reference to any specified future tax consequences, such as the carry-back of non-capital losses under paragraph 111(1)(*a*), and B adjusts that amount at the end of the taxation year to the extent that specified future tax consequences for preceding taxation

years reduce the corporation's taxable income subject to tax at the general corporate rate in section 123 of the Act. As a result, a CCPC or DIC can have a negative GRIP.

The bulk of the GRIP is contained in the description of A, which itself is the positive or negative amount determined by another formula:

$$C + 0.68(D - E - F) + G + H - I$$

C is the corporation's GRIP at the end of the preceding taxation year, which again as noted above can be a nil or negative amount and at this stage in the formula is unadjusted for eligible dividends paid by the corporation in that preceding taxation year.

The next part of the formula, 0.68(D – E – F), is intended to generate an amount equal to the after-tax earnings of the corporation, assuming a notional combined federal-provincial general corporate tax rate of 32%. D is the corporation's taxable income for the taxation year, unless the corporation is a DIC, in which case the amount is nil. (The taxable income of most DICs is already taxed at a preferential rate under subsection 137.1(9). See commentary on new subsection 89(15) of the Act.)

Taxable income in respect of which the corporation has benefited from the small business deduction under subsection 125(1) (including a deduction under that subsection by reason of subsections 137(3) and (4) of the Act) – E – is subtracted from the D amount. If the corporation is a CCPC, its aggregate investment income for the particular taxation year –F – is also subtracted from the D amount. In any other case, the amount for F is nil.

G and H are additions to the GRIP generally in respect of amounts received from other corporations. Eligible dividends received by the corporation in the particular taxation year and amounts deductible by the corporation under section 113 in respect of dividends received from a foreign affiliate are included under the G amount.

H includes in the GRIP the total of all amounts determined under new subsections 89(4) to (7) (see commentaries on those subsections). Broadly speaking, these provisions add amounts to a corporation's GRIP following certain corporate changes, such as amalgamations and windings-up, as well as a limited addition in respect of corporate earnings generated before 2006.

I reduces a corporation's GRIP for a particular taxation by the eligible dividends paid by it in its preceding taxation year, but only to the extent that the corporation did not make excessive eligible dividend designations in respect of the eligible dividends. However, if subsection 89(4) applies to the corporation in the particular taxation year, the amount for I is nil.

The new definition "general rate income pool" in subsection 89(1) applies in respect of taxation years that end after 2005.

"low rate income pool"

The new definition "low rate income pool" in subsection 89(1) of the Act applies in respect of a corporation (referred to in the definition as a non-CCPC) that is neither a Canadian-controlled private corporation (see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7), and new subsection 249(4.1)) nor a deposit insurance corporation (within the meaning assigned by new subsection 89(15); see commentary on that subsection), and is generally relevant for determining the extent to which the non-CCPC can pay eligible dividends in any given taxation year without making an excessive eligible dividend designation (see commentary on the definition "excessive eligible dividend designation" in subsection 89(1)).

The low rate income pool (LRIP) of a corporation at any time in a particular taxation year is the amount determined by reference to a formula:

$$(A + B + C + D + E + F) - (G + H)$$

A is a non-CCPC's LRIP at the end of its preceding taxation year. It is worth noting that, unlike the general rate income pool (see commentary on the new definition "general rate income pool" in subsection 89(1)), the LRIP is computed at any particular time in a taxation year, and therefore the non-CCPC's LRIP at the end of the preceding taxation year is already adjusted to take into account any taxable dividends other than eligible dividends paid, and excessive eligible dividend designations made, by the non-CCPC in the preceding taxation year (see also the discussions below of G and H in formula).

B includes in the LRIP the total of all amounts each of which is an amount deductible under section 112 of the Act in computing the non-CCPC's taxable income for the year in respect of a taxable dividend (other than an eligible dividend) that became payable, in the particular taxation year but before the particular time, to the non-CCPC by a corporation resident in Canada. The B amount will thus typically include dividends paid to a non-CCPC by a CCPC. The link to deductibility under section 112, meanwhile, means among other things that the LRIP of a non-CCPC that is a mortgage investment corporation (MIC) will not be increased by the receipt of such taxable dividends, since the deduction under section 112 is unavailable to MICs pursuant to paragraph 130.1(1)(b) of the Act. (See also the discussion below of G, which contains the corresponding treatment of taxable dividends (other than eligible dividends) paid by MICs.)

C includes in the LRIP the total of all amounts determined under new subsections 89(8) to (10) (see commentaries). Broadly speaking, these provisions add amounts to a corporation's LRIP following certain corporate changes, such as amalgamations and windings-up.

D includes in a non-CCPC's LRIP the after-tax amount of its aggregate investment income for its preceding taxation year (assuming a notional tax rate of 20%) . Only a non-CCPC that would, but for an election made under new subsection 89(11) of the Act in respect of the definition "Canadian-controlled private corporation", have been a CCPC in its preceding taxation year is required to include an amount in respect of D.

E is relevant only to a non-CCPC that was a credit union in its preceding taxation year and that deducted an amount, from tax payable for that preceding year, under subsection 137(3) of the Act (such amounts are deemed by subsection 137(4) of the Act to be deducted under subsection 125(1)). The after-tax amount (assuming a tax rate of 20%) of any deduction made under subsection 125(1) of the Act by a non-CCPC that was not a CCPC in the preceding taxation year is included in the non-CCPC's LRIP under E.

F is relevant only if the non-CCPC was an investment corporation in its preceding taxation year. F includes in a non-CCPC's LRIP an amount in respect of any deduction made by the non-CCPC in its preceding taxation year under subsection 130(1) of the Act.

G and H reduce a non-CCPC's LRIP. Broadly put, variable G reduces the LRIP by taxable dividends (other than eligible dividends) paid by the non-CCPC in the particular taxation year but before the particular time. As with eligible dividends, taxable dividends paid by the non-CCPC that are capital gains dividends, within the meaning ascribed by subsection 130.1(4) or 131(1) of the Act or that are deductible by the corporation under subsection 130.1(1) of the Act in computing its income for the particular taxation year or for its preceding taxation year do not reduce the non-CCPC's LRIP.

H reduces a non-CCPC's LRIP by excessive eligible dividend designations made by the non-CCPC in respect of an eligible dividend paid by it in the particular taxation year but before the particular time.

The new definition "low rate income pool" subsection 89(1) applies in respect of taxation years that end after 2005.

GRIP Addition: Becoming a CCPC

ITA
89(4)

New subsection 89(4) of the Act is relevant to the new definition "general rate income pool" (GRIP) in subsection 89(1) of the Act (see commentary). H in the formula in that definition includes, among other things, an amount determined for a particular taxation year under subsection 89(4) in respect of a corporation to which the definition applies.

Generally, subsection 89(4) applies when a corporation changes status from being a corporation that is neither a Canadian-controlled private corporation (CCPC) (within the meaning assigned by subsection 125(7); see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7) and new subsection 249(4.1)) nor a deposit insurance corporation (DIC) (within the meaning assigned by new subsection 89(15); see commentary on that subsection) in its preceding taxation year to a corporation that is either a CCPC or a DIC in a particular taxation year. The amount determined under subsection 89(4) in respect of the corporation is included in computing the corporation's GRIP at the end of the particular taxation year.

If subsection 89(4) applies, the amount included is determined by reference to the formula

$$A + B + C - D - E - F - G - H$$

In broad terms, this formula is intended to determine what the corporation's GRIP would have been at the end of its preceding taxation year had it been either a CCPC or a DIC in that taxation year.

A, B, and C of the formula augment the amount that will be included in respect the corporation's GRIP. A and B include, respectively, the cost amount to the corporation of all of its property and any money of the corporation immediately before the end of its preceding taxation year.

C generally provides that the amount will be increased to the extent that the corporation has unused and unexpired losses at the end of its preceding taxation year.

D to H of the formula reduce the amount that will be included in respect the corporation's GRIP. D is the total of all amounts each of which is the amount of any debt owing by the corporation, or of any other obligation of the corporation to pay any amount, that was outstanding immediately before the end of its preceding taxation year. E is the paid up capital, immediately before the end of its preceding taxation year, of all the issued and outstanding shares of the capital stock of the corporation, and F is the total of all reserves deducted by the corporation in its preceding taxation year. G and H are, respectively, the capital dividend account, if any, and the low rate income pool of the corporation immediately before the end of its preceding taxation year.

New subsection 89(4) applies to taxation years that end after 2005.

GRIP Addition: Post-amalgamation

ITA
89(5)

New subsection 89(5) of the Act is relevant to the new definition "general rate income pool" (GRIP) in subsection 89(1) of the Act (see commentary). H in the formula in that definition includes, among others, an amount determined for a particular taxation year under subsection 89(5) in respect of a corporation to which the definition applies.

Generally, subsection 89(5) applies when a Canadian-controlled private corporation (CCPC) (within the meaning assigned by subsection 125(7); see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7) and new subsection 249(4.1)) or a deposit insurance corporation (DIC) (within the meaning assigned by new subsection 89(15); see commentary on that subsection) is formed as a result of an amalgamation to which subsection 87(1) of the Act applies. The total of all amounts determined under subsection 89(5) is included in computing the corporation's GRIP at the end of its first taxation year.

Subsection 89(5) is divided into two paragraphs, and their application to a predecessor depends on whether the predecessor was a CCPC or a DIC in its taxation year that ended immediately before the amalgamation (referred to in the subsection as "its last taxation year"). Paragraph (*a*) applies in respect of a predecessor that was a CCPC or a DIC in its last taxation year, and includes the positive or negative amount determined by the formula A – B. This formula is intended to flow through to the corporation's GRIP at the end of its first taxation year a CCPC or DIC predecessor's GRIP at the end of the predecessor's last taxation year (adjusted to take into account any eligible dividends paid and any excessive eligible dividend designations made by the predecessor in that last taxation year).

Paragraph (*b*) applies in respect of a predecessor that was neither a CCPC nor a DIC in its last taxation year, and includes an amount determined by reference to a formula:

$$A + B + C - D - E - F - G - H$$

In broad terms, this formula is intended to determine what the predecessor's GRIP would have been at the end of its last taxation year had it been either a CCPC or a DIC in that taxation year.

A, B, and C of the formula augment the amount that will be included in respect the corporation's GRIP. A and B include, respectively, the total of all amounts each of which is the cost amount to the predecessor of a property and any money of the predecessor immediately before the end of its last taxation year.

C generally provides that the amount will be increased to the extent that the predecessor has unused and unexpired losses at the end of its last taxation year.

D to H of the formula grind the amount that will be included in respect the corporation's GRIP. D is the total of all debts owing by the predecessor, or of any other obligation of the predecessor to pay any amount, that was outstanding immediately before the end of its last taxation year. E is the paid up capital, immediately before the end of its last taxation year, of all the issued and outstanding shares of the capital stock of the predecessor, and F is the total of all reserves deducted by the predecessor in its last taxation year. G and H are, respectively, the capital dividend account, if any, and the LRIP of the predecessor immediately before the end of its last taxation year.

New subsection 89(5) applies to taxation years that end after 2005.

GRIP Addition: Post-winding-up

ITA
89(6)

New subsection 89(6) of the Act is relevant to the new definition "general rate income pool" (GRIP) in subsection 89(1) of the Act (see commentary on that definition in subsection 89(1)). H in the formula in that definition includes, among others, an amount determined for a particular taxation year under subsection 89(6) in respect of a corporation to which the definition applies.

Generally, subsection 89(6) applies in respect of a Canadian-controlled private corporation (CCPC) (within the meaning assigned by subsection 125(7); see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7) and new subsection 249(4.1)) or a deposit insurance corporation (DIC) (within the meaning assigned by new subsection 89(15); see commentary on that subsection) that has wound-up a subsidiary in accordance with subsection 88(1) of the Act. The total of all amounts determined under subsection 89(6) is included in computing the parent's GRIP at the end of its taxation year that that immediately follows the taxation year of the subsidiary in which it was wound-up (referred to in the subsection as the subsidiary's "last taxation year").

Subsection 89(6) is divided into two paragraphs, and their application to the subsidiary depends on whether it was a CCPC or DIC in its last taxation year. Paragraph (*a*) applies if the subsidiary was a CCPC or a DIC in its last taxation year, and includes the positive or negative amount determined by the formula A – B. This formula is intended to flow through to the parent's GRIP the subsidiary's GRIP at the end of its last taxation year (adjusted to take into account any eligible dividends paid and any excessive eligible dividend designations made by the subsidiary in its last taxation year).

Paragraph (*b*) applies if the subsidiary was neither a CCPC nor a DIC in its last taxation year, and includes an amount determined by reference to a formula:

$$A + B + C - D - E - F - G - H$$

In broad terms, this formula is intended to determine what the subsidiary's GRIP would have been at the end of its last taxation year had it been either a CCPC or a DIC in that taxation year.

A, B, and C of the formula augment the amount that will be included in respect the parent's GRIP under the subsection. A and B include, respectively, the total of all amounts each of which is the cost amount to the subsidiary of a property and any money of the subsidiary immediately before the end of its last taxation year.

C generally provides that the amount will be increased to the extent that the subsidiary has unused and unexpired losses at the end of its last taxation year.

D to H of the formula grind the amount that will be included in respect the parent's GRIP, D is the total of all debts owing by the subsidiary, including other obligations of the subsidiary to pay any amount, that were outstanding immediately before the end of its last taxation year. E is the paid up capital, immediately before the end of its last taxation year, of all the issued and outstanding shares of the capital stock of the subsidiary, and F is the total of all reserves deducted by the subsidiary in its last taxation year. G and H are, respectively, the capital dividend account, if any, and the LRIP of the subsidiary immediately before the end of its last taxation year.

New subsection 89(6) applies to taxation years that end after 2005.

GRIP Addition for 2006

ITA
89(7)

New subsection 89(7) of the Act is relevant to the new definition "general rate income pool" (GRIP) in subsection 89(1) of the Act (see commentary on that definition in subsection 89(1)). H in the formula in that definition includes, among others, an amount determined for a particular taxation year under subsection 89(7) in respect of a corporation to which the definition applies.

Subsection 89(7) applies if a corporation was (or, absent an election under new subsection 89(11), would have been), throughout its first taxation year that includes any part of January 1, 2006, a Canadian-controlled private corporation (see commentary on subsection 89(11)). The subsection includes in computing the corporation's GRIP at the end of the taxation year immediately preceding that first taxation year the amount determined by the formula A – B. In general terms, the formula approximates the after-tax amount (based on a notional combined federal-provincial corporate rate of tax of 37%) of the earnings of the corporation that were subject to general corporate tax rate for taxation years of the corporation that ended after 2000 and before 2006 and that have not been paid by the corporation as taxable dividends during those taxation years.

It is intended that, if a corporation includes an amount in computing its GRIP by reason of subsection 89(7), the corporation will have a GRIP in respect of which eligible dividends may be paid as of January 1, 2006. Subsection 89(7) is also intended to accommodate elections made under new subsection 89(11) in respect of taxation years that include January 1, 2006 (see commentary on that new subsection), as well as amalgamations that occur, and windings-up that begin on January 1, 2006, and involve Canadian-controlled private corporations.

Subsection 89(7) applies in respect of taxation years that immediately precede taxation years that include January 1, 2006.

LRIP Addition: Ceasing to be a CCPC

ITA
89(8)

New subsection 89(8) of the Act is relevant to the new definition "low rate income pool" (LRIP) in subsection 89(1) of the Act (see commentary on that definition in subsection 89(1)). C in the formula in that definition includes, among others, an amount determined for a particular taxation year under subsection 89(8) in respect of a corporation to which the definition applies.

Generally, subsection 89(8) applies when a corporation changes status from having been a Canadian-controlled private corporation (CCPC) or a deposit insurance corporation (DIC) in its preceding taxation year to being a corporation that is neither a CCPC nor a DIC in the particular taxation year. The amount determined under subsection 89(8) in respect of the corporation is included in computing the corporation's LRIP at any time in the particular taxation year.

If subsection 89(8) applies, the amount included is determined by reference to a formula:

$$A + B + C - D - E - F - G - H$$

In broad terms, this formula is intended to determine what the corporation's LRIP would have been at the end of its preceding taxation year had it been neither a CCPC nor a DIC in that taxation year.

A, B, and C of the formula augment the amount that will be included in respect the corporation's LRIP. A and B include, respectively, the total of all amounts each of which is the cost amount to the corporation of a property and any money of the corporation immediately before the end of its preceding taxation year.

C generally provides that the amount will be increased to the extent that the corporation has unused and unexpired losses at the end of its preceding taxation year.

D to H of the formula reduce the amount that will be included in respect the corporation's LRIP. D is the total of all debts owing by the corporation, including other obligations of the corporation to pay any amount, that were outstanding immediately before the end of its preceding taxation year. E is the paid up capital, immediately before the end of its preceding taxation year, of all the issued and outstanding shares of the capital stock of the corporation, and F is the total of all reserves deducted by the corporation in its preceding taxation year.

G is the capital dividend account, if any, of the corporation immediately before the end of its preceding taxation year, unless the corporation is a private corporation in the particular taxation year, in which case the amount for G is nil.

H reduces the addition to the corporation's LRIP by the amount determined by the formula I – J, which is the corporation's GRIP at the end of its preceding taxation year, adjusted to take into account any eligible dividends paid and any excessive eligible dividend designations made in respect of any eligible dividends paid by the corporation in its preceding taxation year.

New subsection 89(8) applies to taxation years that end after 2005.

LRIP Addition: Post-amalgamation

ITA
89(9)

New subsection 89(9) of the Act is relevant to the new definition "low rate income pool" (LRIP) in subsection 89(1) of the Act (see commentary on that definition in subsection 89(1)). C in the formula in that definition includes, among others, an amount determined for a particular taxation year under subsection 89(9) in respect of a corporation to which the definition applies.

Generally, subsection 89(9) applies when a corporation that is neither a Canadian-controlled private corporation (CCPC) (within the meaning assigned by subsection 125(7); see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7) and new subsection 249(4.1)) nor a deposit insurance corporation (DIC) (within the meaning assigned by new subsection 89(15); see commentary on that subsection) is formed as a result of an amalgamation to which subsection 87(1) of the Act applies. The total of all amounts determined under subsection 89(9) is included in computing the corporation's LRIP at any time in its first taxation year.

Subsection 89(9) is divided into two paragraphs, and their application to a predecessor depends on whether the predecessor was a CCPC or DIC in its taxation year that ended immediately before the amalgamation (referred to in the subsection as "its last taxation year"). Paragraph (*a*) applies in respect of a predecessor that was neither a CCPC nor a DIC in its last taxation year, and includes the predecessor's LRIP at the end of its last taxation year.

Paragraph (*b*) applies if the predecessor was either a CCPC or a DIC in its last taxation year, and includes an amount determined by reference to a formula:

$$A + B + C - D - E - F - G - H$$

In broad terms, this formula is intended to determine what the predecessor's LRIP would have been at the end of its last taxation year had it been neither a CCPC nor a DIC in that taxation year.

A, B, and C of the formula augment the amount that will be included in respect the corporation's LRIP. A and B include, respectively, the total of all amounts each of which is the cost amount to the predecessor of a property and any money of the predecessor immediately before the end of its last taxation year.

C generally provides that the amount will be increased to the extent that the predecessor has unused and unexpired losses at the end of its last taxation year.

D to H of the formula grind the amount that will be included in respect the corporation's LRIP. D is the total of all debts owing by the predecessor, including other obligations of the predecessor to pay any amount, that were outstanding immediately before the end of its last taxation year. E is the paid up capital, immediately before the end of its last taxation year, of all the issued and outstanding shares of the capital stock of the predecessor, and F is the total of all reserves deducted by the predecessor in its last taxation year.

G is the capital dividend account, if any, of the predecessor immediately before the end of its last taxation year, unless the corporation is a private corporation in its first taxation year, in which case the amount for G is nil.

H reduces the addition to the corporation's LRIP by the amount determined by the formula I – J, which is the predecessor's GRIP at the end of its last taxation year, adjusted to take into account any eligible dividends paid and any excessive eligible dividend designations made by the predecessor in its last taxation year.

New subsection 89(9) applies to taxation years that end after 2005.

LRIP Addition: Post-winding-up

ITA
89(10)

New subsection 89(10) of the Act is relevant to the new definition "low rate income pool" (LRIP) in subsection 89(1) of the Act (see commentary on that definition in subsection 89(1)). C in the formula in that definition includes, among others, an amount determined for a particular taxation year under subsection 89(10) in respect of a corporation to which the definition applies.

Generally, subsection 89(10) applies in respect of corporation that is neither a Canadian-controlled private corporation (CCPC) (within the meaning assigned by subsection 125(7); see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7) and new subsection 249(4.1)) nor a deposit insurance corporation (DIC) (within the meaning assigned by new subsection 89(15); see commentary on that subsection) that has wound-up a subsidiary. The total of all amounts determined under subsection 89(10) is included in computing the corporation's LRIP at any time in its taxation year that immediately follows the taxation year of the subsidiary in which it was wound-up (referred to in the subsection as the subsidiary's "last taxation year").

Subsection 89(10) is divided into two paragraphs, and their application to the subsidiary depends on whether the subsidiary was a CCPC or DIC in its last taxation year. Paragraph (*a*) applies in respect of a subsidiary that was neither a CCPC nor a DIC in its last taxation year, and includes the subsidiary's LRIP at the end of its last taxation year.

Paragraph (*b*) applies if the subsidiary was either a CCPC or a DIC in its last taxation year, and includes an amount determined by reference to a formula:

$$A + B + C - D - E - F - G - H$$

In broad terms, this formula is intended to determine what the subsidiary's LRIP would have been at the end of its last taxation year had it been neither a CCPC nor a DIC in that taxation year.

A, B, and C of the formula augment the amount that will be included in respect the parent's LRIP. A and B include, respectively, the total of all amounts each of which is the cost amount to the subsidiary of a property and any money of the subsidiary immediately before the end of its last taxation year.

C generally provides that the amount will be increased to the extent that the subsidiary has unused and unexpired losses at the end of its last taxation year.

D to H of the formula grind the amount that will be included in respect of the parent's LRIP. D is the total of all debts owing by the subsidiary, including other obligations of the subsidiary to pay any amount, that were outstanding immediately before the end of its last taxation year. E is the paid up capital, immediately before the end of its last taxation year, of all the issued and outstanding shares of the capital stock of the subsidiary, and F is the total of all reserves deducted by the subsidiary in its last taxation year.

G is the capital dividend account, if any, of the predecessor immediately before the end of its last taxation year, unless the parent is a private corporation in the its taxation year that immediately follows the subsidiary's last taxation year, in which case the amount for G is nil.

H reduces the addition to the parent's LRIP by the amount determined by the formula I – J, which is the subsidiary's GRIP at the end of its last taxation year, adjusted to take into account any eligible dividends paid and any excessive eligible dividend designations made in respect of any eligible dividends paid by the subsidiary in its last taxation year.

New subsection 89(10) applies to taxation years that end after 2005.

Election: Non-CCPC

ITA
89(11) to (13)

New subsections 89(11) to (13) of the Act contain new rules involving an election that may be made by a corporation to be treated for certain purposes as not being a CCPC. Those purposes are described in new paragraph (*d*) of the definition "Canadian-controlled private corporation" (CCPC) in subsection 125(7) of the Act (see commentary on the amended definition in subsection 125(7)) . In order to be so treated at any time in or after a particular taxation year, a corporation must file with the Minister an election under subsection 89(11) on or before its filing-due date for the particular taxation year.

An election made under subsection 89(11) may be revoked by the corporation by filing with the Minister, on or before its filing-due date for a particular taxation year, a notice revoking the election made under subsection 89(11), in which case the election will cease to apply to the corporation at the end of the particular taxation year. However, once a corporation has revoked an election, its ability to subsequently elect under subsection 89(11) or revoke an election under subsection 89(12) will be restricted under subsection 89(13).

Note that the election and the revocation of an election provided for under, respectively, subsections 89(11) and (12) will not be prescribed for the purposes of section 600 of the Income Tax Regulations.

New subsections 89(11) to (13) apply to taxation years that end after 2005.

Dividend Designation

ITA
89(14)

New subsection 89(14) of the Act is relevant to the new definition "eligible dividend" definition in subsection 89(1) of the Act (see commentary on that definition in subsection 89(1)); that definition in turn is most notably relevant for the purposes of the 45% "gross-up" in amended paragraph 82(1)(*b*) of the Act and the corresponding dividend tax credit of 11/18 in new paragraph 121(*b*) of the Act (see commentaries on subsection 82(1) and section 121).

In order for a taxable dividend to be an eligible dividend it must have been, among other requirements, designated as such by the corporation paying the taxable dividend. A corporation designates a dividend it pays at any time to be an eligible dividend by notifying in writing at that time each person or partnership to whom it pays all or any part of the dividend that the dividend is an eligible dividend.

Note that the designation set out under subsection 89(14) will not be prescribed for the purposes of section 600 of the Income Tax Regulations.

New subsection 89(14) applies to taxation years that end after 2005, except that in respect of a dividend paid before this Act is assented to, a designation under subsection 89(14), will be deemed to have been made in a timely manner if it is made on or before the day that is 90 days after the day on which this Act is assented to.

Interpretation – Deposit Insurance Corporations

ITA
89(15)

New subsection 89(15) of the Act contains an interpretive rule that applies for the purposes of the new rules concerning the tax treatment of eligible dividends, most notably for the purposes of the new definitions "general rate income pool" and "low rate income pool" in subsection 89(1) of the Act (see commentaries on those definitions in subsection 89(1)). It clarifies that, for the purpose of those rules, there are to be treated as deposit insurance corporations (DICs) only some of the corporations that are DICs for the purposes of section 137.1 of the Act. The section 137.1 DICs that are not so treated are those incorporated under the Canada Deposit Insurance Corporation Act or deemed by subsection 137.1(5.1) to be a DIC.

New subsection 89(15) applies to taxation years that end after 2005.

Clause 6

Dividend Tax Credit for Eligible Dividends

ITA
121

Section 121 of the Act is a key component of the integration rules for dividends received by individuals from taxable Canadian corporations. In broad terms, an amount (often referred to as the "gross-up") equal to 1/4 of a taxable dividend received by an individual shareholder is included in income under existing paragraph 82(1)(*b*). Existing section 121 provides a corresponding deduction from tax payable by the individual (often referred to as the "dividend tax credit") equal to 2/3 of the gross-up.

Section 121 is amended by introducing a new dividend tax credit of 11/18 of the gross-up in respect of eligible dividends (see commentary on the new definition "eligible dividend" in subsection 89(1)). This new dividend tax credit corresponds to the 45% gross-up included in income under amended subsection 82(1) of the Act in respect of eligible dividends (see commentary on subsection 82(1)). In general terms, the new gross-up and dividend tax credit are intended to integrate earnings subject to the general corporate rate in section 123 of the Act.

The existing 2/3 dividend tax credit is preserved in new paragraph 121(*a*), and is computed by reference to the 25% gross-up included in computing income under subparagraph 82(1)(*b*)(i). The new dividend tax credit in respect of eligible dividends is contained in new paragraph 121(*b*), and is computed by reference to the 45% gross-up included in computing income under subparagraph 82(1)(*b*)(ii).

Amended section 121 applies to dividends paid after 2005.

Clause 7

Interpretation – "Canadian-controlled Private Corporation"

ITA
125(7)

Subsection 125(7) of the Act defines "Canadian-controlled private corporation" (CCPC), among other terms. This definition applies not only to the small business deduction under section 125 but also, through its incorporation by reference into subsection 248(1) of the Act, to the Act as a whole.

The definition is amended by adding a new paragraph. New paragraph (*d*) permits a corporation that would otherwise be a CCPC and that has filed an election as required under new subsection 89(14) (see commentary on that subsection) to be treated for certain purposes as not being a CCPC, most notably for the purposes of the small business deduction in subsection 125(1) of the Act and most of the new rules concerning the tax treatment of eligible dividends (see commentary on the definition "eligible dividend" in subsection 89(1)).

New paragraph (*d*) of the definition applies to the 2006 and subsequent taxation years.

Clause 8

Consequential Amendment to Paragraph 127.52(1)(*f*)

ITA
127.52(1)(*f*)

Section 127.5 of the Act levies the minimum tax payable by an individual under Part I of the Act for a particular taxation year, and paragraph 127.52(1)(*f*) of the Act is relevant in computing an individual's minimum tax base for the particular taxation year under subsection 127.52. Under existing paragraph 127.52(1)(*f*), the existing "gross-up" in respect of taxable dividends received from taxable Canadian corporations that is included in income under paragraph 82(1)(*b*) of the Act is excluded in computing the minimum tax base.

Consequential to amendments to subsection 82(1), paragraph 127.52(1)(*f*) is amended so that an individual's minimum tax base is computed without reference to paragraph 82(1)(*b*). As a result, amounts included in income in respect of the existing 25% gross-up for taxable dividends (other than eligible dividends), now provided for in subparagraph 82(1)(*b*)(i), and the new 45% gross-up for eligible dividends, provided for in subparagraph 82(1)(*b*)(ii) (see commentary on amended subsection 82(1)) are excluded from an individual's minimum tax base.

Amended paragraph 127.52(1)(*f*) applies to dividends paid after 2005.

Clause 9

Additional Tax on Excessive Eligible Dividend Designations

ITA
Part III.1

New Part III.1 of the Act is enacted as a consequence of the introduction of an enhanced dividend "gross-up" and tax credit for "eligible dividends" paid by corporations resident in Canada to their Canadian-resident individual shareholders. Part III.1 applies a tax to a corporation that has made an "excessive eligible dividend designation" as newly defined in subsections 248(1) and 89(1) of the Act (referred to in these notes as an "excessive designation").

As the definition implies, an excessive designation may be inadvertent, or it may result from an attempt to artificially manipulate a corporation's "general rate income pool" (GRIP) or "low rate income pool" (LRIP) (both of which terms are also defined in subsections 248(1) and 89(1)). The effect of Part III.1 in respect of a particular excessive designation depends on which of these is the case. If the excessive designation arises merely because a Canadian-controlled private corporation (CCPC) or a deposit insurance corporation has as a

factual matter in a given taxation year designated as “eligible dividends” a total amount that exceeds its GRIP at the end of the year (both of which terms are also defined in subsection 89(1)), the tax under Part III.1 is equal to 20% of the excessive designation.

The same 20% rate applies if a corporation that is neither a CCPC nor a deposit insurance corporation happens to pay an eligible dividend at a time when it has a positive balance in its “low rate income pool” (LRIP). In effect, the corporation will face a tax equal to 20% of the amount of the dividend that should have been considered to represent LRIP, and thus should not have been an eligible dividend.

In either of these cases the dividend-paying corporation can (subject generally to its shareholders’ consent) elect to treat all or part of the excessive designation amount as a separate, ordinary dividend – that is not an eligible dividend. To the extent it does this, the Part III.1 tax does not apply, and the shareholders are considered to have received an ordinary dividend to the extent of the elected amount. This optional recharacterization is generally modeled on that offered under existing Part III of the Act in respect of excessive capital dividends and capital gains dividends.

If, however, the excessive designation falls into paragraph (*c*) of the definition “excessive eligible dividend designation” in subsection 89(1), the tax under Part III.1 is imposed at a rate of 30%, on the entire amount of the dividend in question. Additionally, the election described above is not available, meaning that the corporation cannot unwind the effect of its excessive designation.

Regardless which rate of tax applies under new Part III.1, if a CCPC or a deposit insurance corporation pays an eligible dividend in respect of which it has made an excessive designation to a non-arm’s length shareholder, the shareholder is jointly and severally, or solidarily, liable for a proportionate amount of the corporation’s tax under the Part in respect of the dividend.

Part III.1 generally applies to taxation years that end after 2005. The only exception is a special accommodation provided for elections under new subsection 185.1(2) of the Act (described below). If a corporation pays a dividend before this legislation is enacted, and the corporation wishes to make that election in respect of the dividend, that election will be treated as having been made in a timely manner if it is made within 30 months after Royal Assent to the legislation.

Tax on Excessive Eligible Dividend Designations

ITA
185.1(1)

New subsection 185.1(1) of the Act imposes liability for tax under Part III.1 of the Act. The tax is payable, on or before a corporation’s balance-due day for a given taxation year, if the corporation has made an excessive eligible dividend designation (an “excessive designation” in these notes) in respect of an eligible dividend it has paid in the taxation year. The amount of the tax depends on the nature of the excessive designation. If it arises in a circumstance described in paragraph (*a*) or (*b*) of the definition "excessive eligible dividend designation” in subsection 89(1) of the Act, the tax is equal to 20% of the excessive designation. If paragraph (*c*) of that definition applies, the tax is equal to 30% of the excessive designation: the same 20% that applies in other cases, plus an additional 10%.

It should be noted that, where it applies, paragraph (*c*) of the definition treats the entire amount of an eligible dividend as an excessive designation; as a result, the tax imposed by new subsection 185.1(1) is in that case equal to 30% of the full amount of the eligible dividend, not merely of the amount by which the eligible dividend exceeded the relevant “pool” (GRIP or LRIP, as the case may be).

Election

ITA
185.1(2) to (4)

A corporation that would otherwise be subject to tax under Part III.1 of the Act in respect of an excessive designation can, provided certain conditions are met, in effect retroactively undo all or part of the excessive designation. This mechanism is set out in new subsections 185.1(2) to (4) of the Act.

There are three conditions for an election under subsection 185.1(2). First, the excessive designation in question must not be one that is described in paragraph 185.1(1)(*b*) – the election is unavailable where the 30% tax rate applies.

Second, the corporation that made the excessive designation must elect in prescribed manner (i.e., in the manner set out by the Minister of National Revenue) in respect of the excessive designation, and that election must be made on or before the day that is 90 days after the mailing of the notice of assessment that deals with the Part III.1 tax that the corporation would otherwise have to pay. This timing is important: there is no possibility of a late election under Part III.1.

Third, as set out in subsection 185.1(3), the election is valid only with the concurrence of certain shareholders. If the election is made within 30 months of the payment of the dividend that was the subject of the excessive designation (the "original dividend), those shareholders whose concurrence is needed are all those who received or were entitled to receive the original dividend and whose addresses the corporation knew. If the election is made later than that, the concurrence of all of the shareholders who received or were entitled to receive the original dividend is required, regardless of whether the corporation knew their addresses. In this second case (an election more than 30 months after the payment of the original dividend), subsections 152(4) to (5) will not prevent whatever assessment of tax, interest and penalties payable by those shareholders may be needed to take account of the corporation's election.

Subsection 185.1(4) provides an exception to the requirement for shareholder concurrence. If all of the affected shareholders are persons all of whose taxable income is exempt from tax under Part I of the Act, their consent is not necessary. However, the election must in this case be made within 30 months after the payment of the original dividend.

The general effect of a valid election under subsection 185.1(2) is that the original dividend is treated as having been an eligible dividend in a lesser amount, and the corporation is treated as having paid, immediately before the original dividend, a taxable dividend that was not an eligible dividend. The corporation making the election can, subject to its shareholders' concurrence as described above, decide how much (if any) of the original eligible dividend it wishes to have still treated as an eligible dividend. The holders of the shares on which the corporation paid the original dividend are treated as having received, instead of the original dividend, their pro-rata portion of the dividends (or dividend, if the corporation chooses not to leave any part of the original dividend as an eligible dividend) the corporation is now treated as having paid.

Rules Applicable to Part III.1

ITA
185.2

New section 185.2 of the Act sets out several rules that govern the operation of new Part III.1.

Subsection 185.2(1) provides that every corporation resident in Canada that pays a taxable dividend (other than a capital gains dividend) in a taxation year must file a return for the year under Part III.1. The return must be in prescribed form, it must include an estimate of the corporation's tax payable under the Part for the year, and it must be filed no later than the corporation's filing-due date for the year.

Subsection 185.2(2) incorporates into Part III.1 various provisions of the Act dealing with returns, assessments, payments, appeals and other matters, with such modifications as the circumstances require.

If a Canadian-controlled private corporation or a deposit insurance corporation pays an eligible dividend to a non-arm's length shareholder, and makes an excessive designation in respect of the eligible dividend, subsection 185.2(3) provides that the shareholder is jointly and severally, or solidarily, liable with the corporation for a proportionate amount of the corporation's tax under Part III.1. The shareholder's proportion of the corporation's tax is for this purpose equal to the proportion of the eligible dividend that the shareholder received.

Subsection 185.2(4) provides that the Minister may assess a person in respect of an amount payable under subsection 185.2(3) at any time after the last day on which the corporation can elect under subsection 185.2(2) in respect of the excessive designation that gives rise to the amount payable. Such an assessment will use the provisions of Division I of Part I of the Act, including those relating to interest payable, with any required modifications.

Subsection 185.2(5) sets out rules that determine how a payment on account of a liability under subsection 185.2(3) in respect of a particular excessive designation is to be applied to the liability. If it is a shareholder who makes the payment, the payment will discharge the liability to the extent of the payment. If it is the corporation that makes the payment, the payment discharges a proportionate amount of the liabilities of all of the shareholders who received the eligible dividend in question.

Clause 10

Interpretation

ITA
248

Section 248 of the Act defines a number of terms that apply for the purposes of the Act, and sets out various rules relating to the interpretation and application of various provisions of the Act.

Definitions

ITA
248(1)

"eligible dividend"

Subsection 248(1) is amended to provide that the term "eligible dividend" has the meaning assigned in subsection 89(1) of the Act for all purposes of the Act.

"excessive eligible dividend designation"

Subsection 248(1) is amended to provide that the term "excessive eligible dividend designation" has the meaning assigned in subsection 89(1) of the Act for all purposes of the Act.

"general rate income pool"

Subsection 248(1) is amended to provide that the term "general rate income pool" has the meaning assigned in subsection 89(1) of the Act for all purposes of the Act.

"low rate income pool"

Subsection 248(1) is amended to provide that the term "low rate income pool" has the meaning assigned in subsection 89(1) of the Act for all purposes of the Act.

These new definitions in subsection 248(1) apply to taxation years that end after 2005.

Clause 11

Deemed Year-End on Status Change

ITA
249(4.1)

New subsection 249(4.1) of the Act introduces a new deemed taxation year-end rule. In general terms, this rule applies if at any time a corporation becomes or ceases to be a Canadian-controlled private corporation (CCPC) (within the meaning of the amended definition; see commentary on the definition "Canadian-controlled private corporation" in subsection 125(7) of the Act) otherwise than by way of an acquisition of control to which subsection 249(4) of the Act applies. A corporation to which subsection 249(4.1) applies is treated as having a taxation year-end immediately before the time it becomes or ceases a CCPC.

This new rule is particularly relevant for the purposes of the small business deduction in subsection 125(1) of the Act. Subsection 125(1) provides the basic rules for the calculation of a CCPC's small business deduction, an annual tax credit that is calculated as 16% of the least of certain amounts. Under the existing rules, a corporation must be a CCPC throughout any particular taxation year in order to be eligible to claim the small business deduction. One effect of the new deemed year-end rule is that this requirement will in all cases be met where a corporation is a CCPC at any time in a particular taxation year, since under this new rule corporations can no longer be a CCPC for only part of a taxation year.

The new deemed year-end rule is also of particular relevance to the tax treatment of eligible dividends, including new subsections 89(4) and (8) of the Act that apply to include an amount in a corporation's general rate income pool or low rate income pool when the corporation becomes or ceases to be a CCPC (see commentary on the new definitions "eligible dividend", "general rate income pool", and "low rate income pool" in subsection 89(1)).

New subsection 249(4.1) applies to taxation years that end after 2005.